HOUSE BUDGET COMMITTEE

Democratic Caucus

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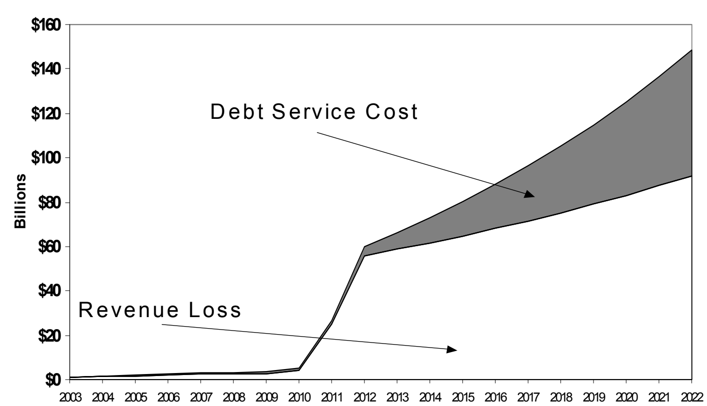
June 4, 2002

Permanent Estate Tax Repeal
Digs the Social Security Deficit Hole Deeper

Dear Democratic Colleague,

House Republicans' response to the recent collapse of revenues and renewed long-term deficits is to make the problem worse. Faced with the prospect of a far worse long-term budget outlook than expected only a few months ago, the House Majority's top legislative priority is to push permanent repeal of the estate tax — purporting to solve a "problem" that doesn't even occur until nine years from now. At a time of national crisis that calls for shared sacrifice, this tax cut will drain more than one trillion dollars from the budget just as the Baby Boom's retirement reaches full force, while benefitting fewer than one percent of taxpayers.

Estate Tax Repeal Cost Balloons in Out Years



One year ago — before September 11, before the recession, and before the plunge of the budget into deficits — Congress bet the budget on a $1.7 trillion tax cut that left no room for error. Our budget committee staff now estimates that this year's deficit (excluding the Social Security Trust Fund surplus) will be $314 billion. Over the next ten years, the non-Social Security deficit will total $2.6 trillion. If these projections are correct, the budget is on course to consume both the entire Social Security surplus and the entire Medicare surplus between now and 2012.

This is because revenues have shrunk. Treasury's tax receipts for the crucial month of April came in 35 percent below last year, but a few hopeful souls looked for a rebound in May. No such luck. May appears to have followed April's pattern, and revenues are still down by as much as a third.

The deterioration of the long-term budget is ***not*** the result of last year's weak economy. The recession has proved shorter and shallower, and the recovery has come sooner and been stronger than anticipated in forecasts at the beginning of the year, due partly to a continuation of the strong productivity growth of the 1990s. Even if the economy recovers more strongly than the Administration and Congressional Republicans predicted a year ago, the on-budget deficit will persist for the rest of this decade and beyond, barring major changes in policy. A cyclical deficit has become a structural deficit, and repeal of the estate tax in 2011 will only make the long-term structural deficit worse.

Even if these figures do not foreshadow weaker results to come, it would be another fiscal blunder to repeal the estate tax permanently. While it may benefit a few thousand lucky taxpayers, painful adjustments will await everyone else. Simple prudence suggests that we put off decisions on major tax cuts until we can see our way out of deficits and back to the surpluses we need to meet our obligations to Social Security and Medicare.

Before rushing to pass more tax cuts and pushing the budget deeper into deficit, consider the following serious flaws in the House Republican estate tax repeal proposal:

- Repealing the estate tax in 2011 will not stimulate the economy in 2002.

- Making estate tax repeal permanent in 2011 would nonetheless reduce tax revenues immediately. Donors would refrain from making taxable gifts now in the hope of bequeathing their assets tax-free a decade from now.

- The tax rules after repeal will be so burdensome and complex that they will not be politically sustainable. The House Republican estate tax proposal requires heirs to carry forward the investment basis of many of the assets left to them and to pay capital gains tax on appreciation that accrued before these assets were bequeathed to them. The "carryover-basis" provisions were added to the bill last year to make it appear that the revenue loss had not gotten totally out of hand — even though the revenue loss still is enormous with the unworkably complex carry-over rules.

- Because of the "carryover-basis" rules, all but the smallest fraction of today's estate taxpayers will be made worse off by repeal of the estate tax in 2011.

- The vast majority of estate taxpayers could be made better off at a fraction of the revenue cost. Simply increasing the unified credit would shelter many currently taxed estates from estate taxes altogether — without the complex carry-over basis rules. These estates would include small-business owners, farmers and ranchers who have the worthiest claim to estate-tax relief.

- Even under existing law, only the wealthiest 2 percent of decedents pay any estate tax at all — with the very wealthiest of those paying the greatest share. Increasing the exemption from the estate tax to $3 million of wealth per person ($6 million per married couple) would reduce the reach of the estate tax to only a fraction of one percent of all decedents. This policy would be more generous for smaller estates because they could continue to use stepped-up basis, and far simpler even for many wealthy estates. And, it would cost only a fraction of the revenue lost from total repeal.

- The estate tax proposal would cut revenues by $55.8 billion in 2012 alone — the first year in which it would have full effect. Assuming that this annual cost would grow at the same rate as GDP thereafter and using CBO's forecast of interest rates, the revenue impact of making repeal permanent would total $109 billion over 2003-2012, and then soar to $1.033 **trillion** over the following decade.

- The baby-boom generation will begin to retire in 2008 and become eligible for Medicare in 2011. Committing now to repeal the estate tax a decade from now would hit the budget at the worst possible time, making it more difficult than ever to raise the necessary funds to make Social Security and Medicare financially sound. Outside analysts have estimated that making the estate tax repeal permanent alone would cost 40 percent of the amount needed to make Social Security financially sound for the next 75 years.

Of all the urgent problems and commitments facing the nation right now, the sunset of last year's repeal of the estate tax nine years from now should not be at the top of the list. A far more responsible use of the Congress's time would be to begin to recognize new realities and craft a bipartisan budget plan to return to the long-term surpluses that were so hastily squandered last year.

Sincerely,

John M. Spratt, Jr.
Ranking Democratic Member